

Chapter 6: Comparison of Returns

In the previous section of this report, four alternatives for replacing trust lands were reviewed: forest lands, agricultural lands, commercial properties and the permanent funds. However, the returns on these four alternatives are not directly comparable. In order to compare the returns on the permanent funds and alternative property investments by the department, the returns must be adjusted for two factors.

First, the investment analysis done by the department on candidate forest and agricultural investments is done on a real (purchasing power) basis but the investment analysis on candidate commercial properties and the returns on the permanent fund are expressed in nominal terms. The returns on commercial properties and the permanent fund need to be adjusted for the loss in the purchasing power of the asset due to inflation to make them comparable to the projected real returns on forestry and agricultural investments.

Second, the returns to the beneficiary from department investments need to be adjusted by removing the management fund deduction to make them comparable to the return on the permanent funds^{29 30}.

These two adjustments are made in Table 16. The gross nominal (before adjustment for lost purchasing power) returns for the permanent fund during FY 1989-2002 and projected return on commercial investments made by the department during FY 1989-2002 are shown in column (A). These returns are reduced by the 3.1 percent loss in purchasing power due to inflation during the study period shown in column (B) of Table 16. The average gross (before management deduction) real return expected on the actual investment in the three categories of replacement real property is shown in column (C). The weights used to calculate the weighted average real return on replacement property are the actual dollar investments made by the department during the FY 1989-2002 period.

²⁹ There is no management fund deduction from the Agricultural Trust lands, so for Agricultural Trust lands the weighted average gross real return on replacement property of 6.7 percent shown in column (C) of Table 16 should be compared to the Net Real Return on the permanent Fund shown in column (E) of 3.7 percent.

³⁰ The cost included in the investment analysis for the replacement properties are paid out of management funds, the reduction of gross real returns by the full 25 percent management deduction results in an under estimate of the net real return to beneficiaries shown in column (E). Also, a portion of the management fund deduction is reinvested into trust assets to generate future returns to beneficiaries. The reinvestment portion of the management fund deduction is akin to retained earnings and should not be deducted from returns to the beneficiaries. To the extent that funds are reinvested back into trust assets, the net real returns to beneficiaries shown in column (E) are under estimated.

The gross real return on investment in replacement assets is then reduced by the 25 percent management fund deduction shown in column (D). Column (E) is the comparable real return to beneficiaries on investment in the permanent fund or replacement properties. The weighted average projected net return on investments in real property assets by the department for the FY 1989-2002 period is 5.0 percent; the comparable average return on the permanent fund for that period is 3.7 percent.

Table 16: Comparison of Returns on Investments

	(A) Gross Nominal Return	(B) Loss in Purchasing Power	(C) Gross Real Return	(D) Less 25% RMCA ³¹	(E) Net Real Return ³²
Real Property Purchases					
Forestry			6.0%	1.5%	4.5%
Agriculture			10.5%	2.6%	7.8%
Commercial	10.1%	-3.1%	7.1%	1.8%	5.3%
Weighted Average³³			6.7%	1.7%	5.0%
Permanent Fund	6.8%	-3.1%			3.7%

Totals may not add due to rounding

The projected real return to beneficiaries of 5.0 percent from purchase of replacement trust properties since 1989 is 32 percent greater than the comparable real return to beneficiaries of 3.7 percent from the permanent fund.

³¹ There is no management fund deduction on the Agricultural Grant Trust revenues in which case, the gross and net returns are the same.

³² Net of 25 percent management costs.

³³ Average return for replacement lands is weighted based on the actual proportion of investment since 1998 in the three land categories shown in Table 5, Timber - 44 percent, Agricultural - 2 percent, Commercial - 54 percent.